

**Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554**

In the Matter of	)	
	)	
Review of Regulatory Requirements Review	)	
of Regulatory Requirements for Incumbent	)	CC Docket No. 01-337
LEC Broadband Telecommunications	)	
Services	)	

**COMMENTS OF DSLNET COMMUNICATIONS, LLC,  
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### SUMMARY

In this proceeding, the Commission seeks to determine the extent to which the incumbent local exchange carriers (“ILECs”) retain market power in the market for “broadband services,” with an eye toward the possible streamlining of regulation of the ILECs’ provision of such services. However, there are fundamental flaws in the Commission’s approach to analyzing these issues that render this Notice of Proposed Rulemaking (“*NPRM*”) an invalid vehicle for reaching conclusions about them, and the Commission should forthwith terminate this proceeding.

First, the *NPRM* expressly declines to define “broadband services” – but no meaningful market analysis can occur without such definition. Second, the *NPRM* fails to adequately take into account the interdependence of the described broadband services with each other and with local exchange services, and the extent to which the ILECs can leverage (and are leveraging) their monopoly position in the latter into dominance of the former. Third, the broadband market is still far too new and small to permit any reasonable extrapolation of what the ultimate market structure will be. Fourth, the *NPRM* does not adequately address the effect of the proposal on intramodal competition between ILECs and competitive local exchange providers (“CLECs”). Fifth, the *NPRM* fails to recognize that the ILECs’ assertion that only they can provide broadband services is itself clear evidence that they retain market power. Sixth, the *NPRM* greatly exaggerates the extent of intermodal competition between ILEC service offerings and those of other service providers.

Moreover, there is no basis to conclude – and the evidence is overwhelming to the contrary – that ILEC deregulation would in fact promote the goal of widespread provision of broadband services. In fact, under dominant carrier regulation, the ILECs are already rapidly deploying broadband services, and are spending billions of dollars to do so. The ILECs have deployed such services where intramodal competition has arisen and scaled back deployment

and/or raised prices where such competition has fallen away – demonstrating that competition, not deregulation, is the best incentive for such deployment. The Commission has found already that deployment of advanced services is occurring on a reasonable and timely basis. But even if this were not so, the pace of deployment of such services is not being held back by dominant carrier regulation but is being driven by market forces, such as the lack of a “killer application” to stimulate demand.

In sum, there is no demonstrated need for the proposed deregulation, and such deregulation would not only fail to achieve the Commission’s goal, it would in fact set back the deployment of broadband services by making it easier for the ILECs to drive their competitors from the market. The Commission should so find, and should terminate this proceeding. If the Commission determines to proceed, it must first issue a further notice of proposed rulemaking to define the market(s) it is analyzing.

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DSLNet Communications, LLC, Focal Communications Corporation, and PacWest Telecomm, Inc. (“Commenters”) submit these comments in response to the Commission’s Notice of Proposed Rulemaking in the above-captioned proceeding,<sup>1</sup> concerning regulation of incumbent local exchange carriers’ (“ILECs”) provision of broadband telecommunications services. As discussed in these comments, the Commission should peremptorily terminate this proceeding in light of basic flaws in the approach and framework for analyzing market power set forth in the *NPRM*. It would be useful, however, for the Commission in this proceeding to reject the ILECs’ false argument that deregulation of them would promote provision of broadband services to all Americans.

**I. THE COMMISSION’S FRAMEWORK FOR ANALYSIS OF MARKET POWER IS FLAWED AND INCOMPLETE**

**A. The Commission’s Failure To Define “Broadband” Services Precludes A Rational Analysis Of Market Power In This Proceeding.**

In this proceeding, the Commission intends to determine the extent to which the ILECs retain market power in “broadband services.” Drawing analogies to a number of its past

proceedings, the Commission establishes a theme of progressive deregulation of increasingly competitive markets. Then it poses the question whether the ILECs' broadband service offerings are now subject to a sufficient degree of competition as to warrant streamlining the regulation of these service offerings.<sup>2</sup> But there is a glaring flaw in the Commission's approach: it fails to define what it means by "broadband services." Indeed, it does not even propose to define "broadband services" as an outcome of this rulemaking. Instead, it expressly avoids the issue here and defers such definitional considerations to an entirely separate proceeding: "By using the term broadband services, we intend to avoid statutory-based definitional issues and instead focus on addressing the relevant markets in which these services participate. We will be addressing these issues in the forthcoming Title I broadband proceeding...."<sup>3</sup>

While Commenters appreciate the difficulty in defining "broadband," lack of such a definition makes it impossible to submit meaningful comments in response to the questions posed in the *NPRM*. Unless the Commission defines clearly what it means by "broadband services," Commenters cannot identify the relevant product market in which these services are bought and sold or explain any relationship with other product markets. Yet such a definition is, as the Commission acknowledges, fundamental to the question of whether the ILECs should be regulated as dominant carriers in their provision of these services. An even more basic problem is this: whatever form of regulation the Commission might decide to adopt for these services, how can it draft appropriate regulations if it does not face the question of exactly what services these regulations apply to? The Commission states: "While we recognize that parties'

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<sup>1</sup> *Review of Regulatory Requirements for Incumbent LEC Broadband Telecommunications Services*, Notice of Proposed Rulemaking, CC Docket No. 01-337, FCC 01-360, released December 20, 2001 ("*NPRM*").

<sup>2</sup> *NPRM* at paras. 4-6.

<sup>3</sup> *NPRM* at para. 17, n.37, referring to *Appropriate Framework for Broadband Access to the Internet Over Wireline Facilities*, Notice of Proposed Rulemaking, CC Docket No. 02-33, FCC 02-42, released February 15, 2002.

identification of the relevant product markets may vary depending on the definition of ‘broadband services,’ our goal is to rigorously define the relevant markets so as to include all reasonably substitutable services.”<sup>4</sup> Nevertheless, nowhere does the Commission state how it will determine which products are “reasonably substitutable” for a class of services which it declines to define in the first place.

Failing to define the very thing about which the Commission purportedly intends to make key regulatory decisions precludes any lawful resolution in this proceeding of “broadband” market power issues. As the Supreme Court stated in *Motor Vehicle Manufacturers Ass’n of the U.S, Inc. v. State Farm Mutual Automobile Insurance Company*, 463 U.S. 29, 43, 103 S.Ct. 2856, 2867: “Normally, an agency rule would be arbitrary and capricious if the agency has relied on factors which Congress has not intended it to consider, *entirely failed to consider an important aspect of the problem*, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise.” (Emphasis added.) *See also, e.g., American Telephone & Telegraph Co. v. FCC*, 974 F.2d 1351, 1354 (D.C. Cir. 1992). It is difficult to see what could be more important in determining whether ILECs retain market power with regard to certain services than *defining what services are being considered*.

For all of these reasons, the Commission’s failure to consider the definition of broadband services in this proceeding precludes any rational or lawful determination of the extent to which ILECs have market power in the provision of “broadband” services. Any record developed herein will therefore be insufficient by definition to support any determination of whether ILECs remain dominant in the provision of “broadband” services. Moreover, while the Commission

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<sup>4</sup> NPRM at 18.

may craft a definition of “broadband” based on the record, it will need to issue a further NPRM in light of that definition before it could lawfully establish any regulatory framework for it.

**B. ILECs Can And Will Leverage Their Dominance In Local Exchange Services Into The Broadband Market.**

The framework for assessing ILEC market power described in the *NPRM* fails to take into account the interdependence of the various described services with each other and with the ILECs’ local exchange service. As a result of this interdependence, any declaration that the ILECs have become non-dominant in the provision of broadband services would be unsupportable.

The Commission suggests that at least two relevant product markets may exist.<sup>5</sup> In one, the “mass market,” the only ILEC offering it cites is DSL.<sup>6</sup> By contrast, in the other relevant product market tentatively identified by the Commission, the “larger business” market, the Commission identifies several ILEC offerings as being potentially included. These include Frame Relay, Asynchronous Transfer Mode (“ATM”), Gigabit Ethernet (“GigE”), Switched Multimegabit Data Service (“SMDS”) and Remote Local Area Network (“RLAN”) service.<sup>7</sup> The Commission asks for comment on whether separate small and medium enterprise (“SME”) and small or home office (“SOHO”) markets exist, as well as on whether it should distinguish between the wholesale and retail markets.

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<sup>5</sup> *NPRM* at paras. 19-22

<sup>6</sup> The Commission identifies cable modem, fixed wireless and satellite services – all non-ILEC services – as other products that might provide “intermodal” competition in the mass market. *NPRM* at para. 21.

<sup>7</sup> The Commission states that it will not consider whether traditional special access services (and by implication, traditional data private line services) belong in the larger business market “as these services are governed by the Commission’s pricing flexibility regime.” *NPRM* at para. 22. But this is a non sequitur. The issue of whether these services are in this market has to do with the degree to which customers see them as substitutes for each other, not with how they are classified for regulatory purposes. Of course, leaving them out of the analysis will also have the effect of significantly understating the ILECs’ market share. The *NPRM* is also silent as to the competitive role ISDN – another ILEC offering – might play in this market.



In defining its market analysis exclusively by reference to these narrowly-defined end products, the Commission suggests that it could find ILECs non-dominant in one or more of these markets *notwithstanding the fact that the ILECs continue to have market power with respect to basic local exchange service and that all these services are provided over the same local exchange and exchange access facilities.*<sup>8</sup> The Commission seeks comment as to whether the ILECs have market power “[w]ithin each relevant product . . . market...”<sup>9</sup> But this approach simply ignores the substantial supply-side interdependence of all of these narrow segments of the broadband market with each other *and* with core indisputably dominant ILEC services. Not least among the complications arising from this interdependence is the proper analytical treatment of the large joint costs and jointly used resources among all these segments.<sup>10</sup>

The importance of this interdependence – and the seriousness of the failure of the *NPRM* to come to grips with it – cannot be stressed enough. Even if ILEC broadband offerings taken on a stand-alone basis are potentially subject to competition (*e.g.*, from cable modems, as the Commission suggests), the ILECs’ ability to pursue this market stems directly and inescapably from their ability to piggy-back the construction of broadband facilities upon the core voice telephone network. This gives the ILECs a significant economic advantage of integration that is unavailable to competing, non-integrated providers. Inevitably, they will be able to leverage this integration in a manner that effectively excludes CLECs from significant segments of the market, and they are doing so today.

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<sup>8</sup> As Chairman Powell notes in his separate statement (at page 1) the ILECs remain “clearly dominant” in local exchange service.

<sup>9</sup> *NPRM* at para. 28.

<sup>10</sup> The Commission’s separation of large business users from small business and residential users is oversimplistic as well. Many large businesses have small locations – airline ticket offices and bank branches, for example – that have similar needs to those of small businesses. These locations may well have a use for DSL, especially if it can be used to connect them with private networks rather than the Internet. At the same time, since cable is primarily a residential service, it does not pass many business locations, and so these users too are without meaningful alternatives to DSL in the broadband arena.

One illustration of this problem is the ILECs' practices with regard to sub-loop unbundling, which has an enormous impact on competition in what the Commission would refer to as the mass market. ILECs are rapidly extending fiber into feeder plant and are deploying DSLAMs at remote terminals ("RTs"), where the fiber is cross-connected with copper distribution plant, in each of the various neighborhoods served by the same central office wire center building, bypassing CLEC interconnections and/or collocated facilities at the central office. This hybrid fiber/copper loop plant is used jointly to provide ordinary telephone service as well as DSL services, yet the ILECs refuse to allow CLECs either to interconnect with the DSLAMs at the RTs or to collocate their own facilities at those network points. This effectively denies CLECs access to the copper loop and precludes them from providing DSL services to end users served by the RTs. By this stratagem, ILECs can effectively block CLECs from competing in the "mass market" for broadband services unless the CLECs are prepared to overbuild the *entire* ILEC feeder *and* distribution network. It goes without saying that such an overbuild could not be justified as an economic matter. Thus, if left unchecked, ILECs can eliminate CLECs as a competitor in the "mass market." Such practices can also preclude competition in the business market.

This is but one example of the anticompetitive behavior that the ILECs are already engaged in, which demonstrates that ILECs control of the facilities used to provide dominant local exchange services and broadband services is a circumstance that by itself precludes any finding of nondominance for broadband services even if there is some competition in provision of the end product to consumers. On this basis alone, the most useful step the Commission could take at this point would be to peremptorily terminate this proceeding.

**C. The Broadband Market Is Too New and Small to Permit A Meaningful Market Power Analysis.**

The ILECs argue, in effect, that their ability to leverage control of local exchange facilities does not actually exist because, so far anyway, they have not succeeded in monopolizing the broadband market. In its petition for nondominant treatment,<sup>11</sup> for example, SBC argues that it cannot possibly be dominant in broadband in the mass market, because, to date, there are more cable modem users nationwide than there are DSL users. But this is hardly persuasive. Current mass market penetration for all broadband services remains extremely low.<sup>12</sup> The mass market purchasers to date have been early adopters, who typically subscribe to whichever service is available to them first. Thus, subscribership to cable modem services is largely a factor of the extent to which it got there first, inasmuch as it was available in many areas before DSL, and (as further discussed below) in many areas remains the only choice available to consumers. In other words, the relative penetration of DSL and cable modems into the market is reflective of consumers' *lack* of choices, not of consumers' choosing between two competitive alternatives.<sup>13</sup>

For this reason, analyzing the competitiveness of the "mass market" for broadband services in light of current "market shares" is invalid from the outset. It is simply not possible to extrapolate what the ultimate market structure will be from market shares that exist at this nascent stage. And even if one believes that intermodal competition from cable modems, satellite and fixed wireless is real, premature deregulation of the ILECs could snuff it out as the

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<sup>11</sup> SBC Petition For Expedited Ruling That It Is Non-Dominant In Its Provision Of Advanced Services And For Forbearance From Dominant Carrier Regulation Of Those Services, filed Oct. 3, 2001, at 38 *et seq.*

<sup>12</sup> The various sources cited by SBC are widely disparate in their estimates of DSL and cable penetration. Nevertheless, they agree that only a few million households have either of these services or other broadband services today.

<sup>13</sup> It appears likely that the ILECs' sluggish roll-out of DSL in many areas has been part of their strategy to deny access to CLECs. In many cases, ILECs have delayed implementing DSL until building out fiber to the RTs, which, as noted above, gave them the opportunity to shut out the CLECs.

market size increases and ILECs take more and more advantage of their leveraging opportunities. In short, it is far too early in the development of provision of “broadband” services for the Commission to reach any conclusions about the market power of ILECs. In light of this, the Commission should peremptorily terminate this proceeding.

**D. The NPRM Does Not Adequately Consider The Effects Of The Commission’s Proposal On Intramodal Competition.**

In the Commission’s and SBC’s focus on intermodal competition, there is one glaring silence: neither has examined the continuing role of the CLECs in this market. It is clearly part of the fundamental policy of the Telecommunications Act that *intramodal* competition, from competing carriers such as CLECs that rely in part on interconnection with ILEC facilities, is to be fostered. The Commission must be careful to ensure that its focus on intermodal competition does not result in a regulatory structure that facilitates the ILECs’ continuing efforts to eliminate intramodal competition.<sup>14</sup> Even under current regulation, ILECs have succeeded in driving several players (Rhythms and Northpoint, for example) from the marketplace, through the sheer exercise of market power and the anticompetitive tactics described above. Any loosening of regulation would merely embolden the ILECs and strengthen their hand at driving the remainder of their intramodal competitors from the field.

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<sup>14</sup> The *NPRM* does not itself call for the elimination of the Section 251 and *Computer II/III* unbundling obligations with respect to broadband facilities, leaving those issues to the *Triennial UNE Review* and *Broadband NPRM*. But if the Commission were to conclude here that broadband services are competitive,” the ILECs will likely argue that the “necessary” and “impair” standards that provide the basis for establishing Section 251 unbundling obligations do not apply, on the basis that CLECs’ ability to provide broadband services is not “impaired” by the unavailability of broadband UNEs from the ILEC, nor are such facilities “necessary” for CLEC provisioning of these services, since in a “competitive” market, these facilities are presumably available elsewhere. Though this argument is belied by the fact of the extensive joint use of facilities between ILEC broadband services and the monopoly exchange services, the argument will nevertheless be made, and the Commission should resist it.

**E. The ILECs' Argument That Only They Can Provide Widespread Broadband Development Underscores the Fact That They Retain Market Power.**

There should be no doubt that the elimination of potential competition from CLECs in provision of broadband services is the ILECs' goal. They have been arguing in a variety of arenas that their Section 251 and 252 obligations to provide CLECs with access to facilities, as well as dominant carrier regulation itself, cause them not to make the necessary investments to allow the widespread deployment of broadband services – and so, they assert, these burdens should be lifted. But it is here that their argument reveals its internal inconsistency. For the ILECs go on to claim that if they don't make this investment then nobody else will either, and that the nation will therefore be deprived of this valuable resource. Yet this argument flies in the face of their other claim: that the market is *already competitive* – which could only be true if other parties have in fact made *and will continue to make* investments toward providing such services. The truth is that the ILECs need to maintain the fiction of a robustly competitive market in order to justify the regulatory freedoms they are seeking, but also need to brandish the club of a refusal to invest altogether – and thus to deny the nation a broadband network – in order to pressure the Commission to give them what they want. The ILECs' arguments are in reality no more than the traditional argument of dominant carriers, *i.e.*, promises to provide new services in exchange for permitting them to keep their monopoly. The Commission should recognize that this argument verifies that the ILECs are dominant carriers and so find in this proceeding.

**F. Intermodal Competition Is Insignificant.**

Finally, the *NPRM* greatly exaggerates the extent of intermodal competition in the provision of “broadband” services. Upon closer review, it is clear that intermodal competition is far too insignificant to justify a conclusion that it constrains ILECs' market power.

As to the “larger business” market, the Commission has identified no intermodal competition at all. All the services cited as examples in this market – Frame Relay, ATM, GigE, SMDS and RLAN – are offered by ILECs. Thus, in this part of the market, intramodal competition is all there is. But the *NPRM* fails to set forth any effective method for protecting this market from the ILECs’ leveraging their control over bottleneck facilities and eliminating intramodal competition as well.

As to the “mass market,” the Commission identifies three “service platforms” as intermodal competitors for the ILECs’ DSL offerings: cable modem service, satellite and fixed wireless. But none of these is a serious competitor for DSL at this point in time. First, while cable is touted as the most important competitor for DSL, two-thirds of American homes do not now have a choice between wireline and cable broadband services. That means that, for the vast majority of the “mass market,” no intermodal competition between cable and DSL exists at all.<sup>15</sup> Should an ILEC raise DSL prices, then, most of its subscribers would *not* have a cable alternative.

Even in areas in which both cable and DSL are available, the level of market concentration is still much too high to allow effective competition. In 2000, the Department of Justice (“DOJ”) sued to stop the proposed WorldCom-Sprint merger on the ground that after the merger, the market share of the combined entity together with that of AT&T would result in unacceptable market concentration in both the Internet backbone market and the long distance market. In the former, the post-merger Herfindahl-Hirschman Index (“HHI”), the standard measure of market concentration, would have risen from about 1850 to about 3000 by the DOJ’s

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<sup>15</sup> McKinsey & Co. and J.P. Morgan H&Q, *Broadband 2001: A Comprehensive Analysis of Demand, Supply, Economics, and Industry Dynamics in the U.S. Broadband Market* (April 2001), pp. 40-43.

reckoning.<sup>16</sup> In the long distance market, the rise would have been from about 3500 to about 3800.<sup>17</sup> The DOJ noted: “Markets in which the HHI is between 1000 and 1800 points are considered to be moderately concentrated, and those in which the HHI is in excess of 1800 points are considered to be highly concentrated.”<sup>18</sup> Not only did the DOJ reach this conclusion, the United States Telephone Association (“USTA”)<sup>19</sup> decried the proposed merger as creating a “monster duopoly” between the merged entity and AT&T, giving the two companies “extreme power over consumers.”<sup>20</sup>

But in areas where both cable and ILEC broadband services are present, the market is concentrated far beyond even the levels which the DOJ found unacceptable. The relative subscriber shares of cable and ILEC services today are approximately 56 percent and 44 percent, respectively.<sup>21</sup> Assuming the same proportions in the areas in which both are available, the HHI in each such area would be *over 5000*, far in excess of the market concentration level found unacceptable by the DOJ and USTA.<sup>22</sup>

Nor do satellite services pose any significant competitive threat to DSL, for several reasons. First, of the two market entrants, Hughes’ services generally require that uploads be

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<sup>16</sup> See Complaint, *U.S. v. WorldCom, Inc.*, Civil Action No. \_\_\_, (D.D.C. June 26, 2000) (“DOJ Complaint”) at para. 32 (copy at <http://www.usdoj.gov/atr/cases/f5000/5051.htm>).

<sup>17</sup> *Id.* at para. 62.

<sup>18</sup> *Id.* at Appx. A.

<sup>19</sup> Now the United States Telecom Association.

<sup>20</sup> Press Release, “USTA Calls for Careful Scrutiny of MCI Worldcom Takeover of Sprint: Creation of Monster ‘Duopoly’ Should Force FCC to Let Bells Into Long Distance,” October 5, 1999, <http://www.usta.org/releases/rls99-47.html>.

<sup>21</sup> *In the Matter of Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable And Timely Fashion, and Possible Steps To Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996*, CC Docket 98-146, rel’d Feb. 6, 2002 (“*Third Advanced Services Report*”) at Appx. C, Table 2.

<sup>22</sup> The HHI is calculated by summing the squares of the market participants. DOJ Complaint at Appx. A. Accordingly, the HHI here is  $(56^2) + (44^2) = 5072$ . The extremely small numbers of satellite and wireless subscribers obviously do not materially affect this number.

done through a separate dial-up link – at dial-up speeds.<sup>23</sup> StarBand’s services use a wireless upload link, at speeds of 40-60 Kbps, comparable to, if not worse than, dial-up speeds.<sup>24</sup> These services are really just a subset of somewhat improved dial-up services. Moreover, to date they are being priced in the range of \$70 per month,<sup>25</sup> hardly competitive with the pricing of DSL, at \$50 per month.<sup>26</sup> In terms of market power, this means that an ILEC could raise its DSL rates by *forty percent* and still not fear losing customers to the satellite providers – and there would be some significant premium it could collect even above that for its faster service.

Fixed wireless providers pose no greater competitive threat to ILEC dominance than do satellite providers. The *Third Advanced Services Report* describes in detail the logistical difficulties and technical limitations that constrain its roll-out.<sup>27</sup> These include difficulty in obtaining access to rooftops to install antennas, line-of-sight requirements, spectrum scarcity (which also affects satellite services), small cell sizes for some bands, and weather issues. Small wonder, then, that satellite and fixed wireless together only accounted for a paltry 73,476 lines as of June 2001, barely one percent of the market.

It is evident that none of the intermodal competitors identified by the Commission seriously constrains the ILECs’ market power. The regulatory “relief” they request would enable them to wipe out the possibility that CLECs’ broadband services could ever provide effective

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<sup>23</sup> *Third Advanced Services Report* at Appx. B, para. 47.

<sup>24</sup> *Id.* at para. 48. Hughes has a “two-way” service using a wireless uplink as well, but does not show upload speed on its website. It is doubtful that Hughes’ wireless upload speed is much greater than StarBand’s in any event.

<sup>25</sup> Hughes pricing at <https://register.earthlink.net/cgi-bin/wsisa.dll/broadband/satellite/pricing.html?drn=9cd9e606ce965ab8b7856265874157fb>; StarBand pricing at <http://www.starband.com/faq/starbandfacts.htm#cost>.

<sup>26</sup> See, e.g., Verizon “Pricing and Packages,” [http://www22.verizon.com/foryourhome/dsl/order/NLF\\_vzolproductsprequalify.asp](http://www22.verizon.com/foryourhome/dsl/order/NLF_vzolproductsprequalify.asp)

<sup>27</sup> *Third Advanced Services Report* at Appx. B, para. 34 *et seq.*



intramodal competition, and diminish – and probably eliminate – the possibility that effective intermodal competition could ever arise.

**II. THERE IS NO BASIS TO CONCLUDE THAT ILEC DEREGULATION WOULD PROMOTE THE GOAL OF WIDESPREAD PROVISION OF BROADBAND TELECOMMUNICATIONS SERVICES.**

**A. ILECs Are Already Rapidly Deploying Broadband Capability.**

Even if there were any basis for finding ILECs nondominant in the provision of “broadband” services, which there is not, there is no reason to believe that such treatment would promote their construction of broadband facilities, because ILECs are already building them. For example, only 7 months ago, in June 2001, Verizon informed the New York Public Service Commission that the “unprecedented and unpredictable demand” for high speed data circuits required increased capital spending and the deployment of new technologies.<sup>28</sup> In 2000, Verizon’s capital spending for special access services was nearly *4 times* the amount spent just 3 years earlier. In 1999, SBC launched “Project Pronto,” a \$6 billion investment in high-speed residential broadband services to residential consumers.<sup>29</sup> Despite the fact that they had previously ignored DSL, SBC and other ILECs proclaimed that it and other advanced services were “strategic growth driver[s].”<sup>30</sup> More recently, in a January 24, 2002, “Investor Briefing” SBC announced that it had expanded its DSL-capable footprint by 37% in 2001 and that it had the “industry’s largest DSL Internet customer base.”<sup>31</sup> SBC’s public pronouncements regarding data services provided to enterprise customers were equally glowing. SBC announced growth in

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<sup>28</sup> See Opinion and Order Modifying Special Services Guidelines for Verizon New York Inc., Conforming Tariff, and Requiring Additional Performance Reporting, Cases 00-C-2051 and 92-C-0665, Opinion No. 01-1, NYPSC, June 15, 2001, p. 10.

<sup>29</sup> “SBC To Launch \$6 Billion High Speed Internet Effort,” E-Commerce Times, <http://www.ecommercetimes.com/perl/story/1474.html> (October 18, 1999).

<sup>30</sup> SBC Investor Briefing No. 226, [http://www.sbc.com/Investor/Financial/Earning\\_Info/docs/2Q\\_IB\\_FINAL\\_Color.pdf](http://www.sbc.com/Investor/Financial/Earning_Info/docs/2Q_IB_FINAL_Color.pdf), at 5 (July 25, 2001) (“SBC Second Quarter Briefing”).

<sup>31</sup> SBC Investor Briefing No. 228, [http://www.sbc.com/investor\\_relations/financial\\_and\\_growth\\_profile/investor\\_briefings/1,5869,253,00.html](http://www.sbc.com/investor_relations/financial_and_growth_profile/investor_briefings/1,5869,253,00.html), at 2 and 5 (Jan. 24, 2002) (“SBC Fourth Quarter Briefing”).

its data services of between 14.4% and 27.9% in 2001 and 16.9% in the fourth quarter of 2001 for high-speed data transport services.<sup>32</sup> For its part, BellSouth announced 25% growth in data revenues and a 189% increase in DSL subscribers in 2001, which BellSouth noted was “the fastest growth of any DSL or cable provider in the country.”<sup>33</sup> BellSouth claimed that it had “the most aggressive DSL deployment strategy in the industry” and that it had increased its DSL coverage from 45% to 70% of households in 2001.<sup>34</sup>

Obviously, these ILECs deployed the broadband facilities, including fiber in the loop, making these impressive gains possible under dominant carrier regulation.<sup>35</sup> Therefore, there is no reason to believe that dominant carrier regulation has inhibited, or will inhibit, ILECs’ investment in broadband infrastructure to any degree.<sup>36</sup>

## **B. Competition Is The Best Incentive For Infrastructure Investment For All Industry Players**

Apart from the fact that ILECs’ previous and ongoing substantial broadband infrastructure investments refute ILEC claims that dominant carrier regulation inhibits such investment, it is also evident that the threat of competition provides the best incentive for ILECs

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<sup>32</sup> SBC Second Quarter Briefing, at 4; SBC Third Quarter Briefing, at 4; SBC Fourth Quarter Briefing, at 4.

<sup>33</sup> BellSouth investor news, “BellSouth Reports Fourth Quarter Earnings,” [http://www.bellsouth.com/investor/pdf/4q01p\\_news.pdf](http://www.bellsouth.com/investor/pdf/4q01p_news.pdf) (Jan. 22, 2002).

<sup>34</sup> *Id.* Qwest, while lagging behind the other ILECs, nevertheless had impressive growth as well. In January 2002, Qwest announced that DSL customers increased by 74% and revenues from DSL services by 66% in 2001. “Qwest Communications Reports Fourth Quarter, Year-End 2001 Results,” [http://media.corporate-ir.net/media\\_files/NYS/Q/q\\_1\\_28\\_02earnrel.htm](http://media.corporate-ir.net/media_files/NYS/Q/q_1_28_02earnrel.htm) (Jan. 29, 2002).

<sup>35</sup> For a time, SBC and Verizon provided advanced services through affiliates that the Commission had determined were presumptively nondominant. However, the cited network investments were made by the parent companies.

<sup>36</sup> The ILECs also were able to compete effectively for DSL and other data customers. Verizon, for example, reported a 122% increase in DSL subscribers and a 21.2% increase in data transport revenues in 2001. “Verizon Communications Reports Solid Results For Fourth Quarter, Provides Outlook for 2002,” [http://investor.verizon.com/news/VZ/2002-01-31\\_X263602.html](http://investor.verizon.com/news/VZ/2002-01-31_X263602.html) (Jan. 31, 2002). Verizon also announced that it had deployed DSL to central offices serving 79% of Verizon’s local access lines and that its total number of data circuits in service had increased 53% from 2000. News Release, “Verizon Communications Second Quarter Earnings Highlighted by Strong Long-Distance and Wireless Sales,” <http://newscenter.verizon.com/proactive/newsroom/release.vtml?id=59168> (July 31, 2001).

to invest in broadband networks. In fact, the ILECs' pattern of deployment of DSL capable networks perfectly illustrates that competition is the best way to encourage ILECs to deploy broadband networks.

In a nutshell, ILECs ignored DSL until CLECs began to deploy it. As President Clinton's Council of Economic Advisers stated in early 1999:

Although DSL technology has been available since the 1980s, only recently did [the ILECs] begin to offer DSL service to businesses and consumers seeking low-cost options for high-speed telecommunications. The incumbents' decision finally to offer DSL service followed closely the emergence of competitive pressure from ... the entry of new direct competitors attempting to use the local-competition provisions of the Telecommunications Act of 1996 to provide DSL over the incumbents' facilities.<sup>37</sup>

Or, as stated more succinctly by James Glassman, the ILECs "kept cheaper DSL on the shelf for a decade" to protect their higher revenue services.<sup>38</sup> That decision is unsurprising and perhaps even economically rational from the ILECs' point of view, but consumers and businesses were required to bear the higher costs and poorer quality of the ILECs' earlier "high speed" services. Competition from CLECs thus was pivotal in furthering the deployment of DSL and other advanced services.

As described in the previous section, ILECs responded to CLEC entry by increasing their capital spending and the coverage of their DSL-capable networks. Prior to the introduction of commercial DSL services by competitors, the ILECs did little or nothing to encourage the development or deployment of new advanced services, preferring to focus on their existing, and more lucrative, data services. Thus, it was the competitive threat posed by CLECs – particularly

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<sup>37</sup> ALTS New Economy Analysis at 4 (citing Council of Economic Advisers, Economic Report of the President, February 1999, pp. 187-188, <http://w3.access.gpo.gov/usbudget/fy2000/pdf/erp.pdf>)

<sup>38</sup> James Glassman, "Best Remedy for Recession? Break Up the Bells," <http://www.techcentralstation.com/NewsDesk.asp?FormMode=MainTerminalArticles&ID=131> (December 10, 2001).

since DSL holds the promise some day of providing competition in voice service – that stimulated ILEC infrastructure investments necessary to provide this broadband service.

Moreover, it is not coincidental that after two of the “big three” CLEC DSL providers terminated operations and the third filed for bankruptcy, some ILECs announced they were scaling back DSL investment somewhat – although even this maneuver did not prevent them from achieving the record-breaking growth discussed above, so that they now control 90% of customers. For example, in October 2001, SBC quietly scaled back its original deployment plan for Project Pronto and reduced capital spending by 20% in 2002.<sup>39</sup> In short, to the extent any diagnosis other than the general recession is needed to explain these modest scalebacks, it is apparent that ILECs no longer feel the need to make the investment in light of the diminished threat of competition from CLECs. It is also worth noting that some ILECs substantially raised prices for DSL service, which never would have happened in a competitive market. To name only one, in October 2001, SBC raised its wholesale prices for DSL services by approximately 15% (while admitting that its cost to provide DSL connectivity was declining).

As a group of distinguished economists explained in a December 2001 letter to Commerce Secretary Donald Evans: “both history and economic theory have taught us [that] deregulating a monopoly without genuine prospects for competition does not induce it to deploy more infrastructure, only to exploit more severely the infrastructure that it has already in place by limiting its use and raising its price.”<sup>40</sup> In a perfect illustration of this point, SBC reduced investment and raised prices as soon as the threat of broadband competition diminished.

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<sup>39</sup> SBC Advanced Solutions, Inc., Tariff FCC No. 1, pp. 60-69 (eff. Sept. 10, 2001); SBC Second Quarter Briefing, at 5.

<sup>40</sup> Letter from William J. Baumol et al. to Hon. Donald L. Evans et al., dated December 11, 2001, at 3.

**C. Even If The Commission Believes That Broadband Services Are Not Being Deployed Rapidly Enough, Factors Other Than Dominant Carrier Regulation Fully Explain The Pace Of Deployment.**

The Commission recently concluded that the deployment of advanced telecommunications capability was occurring on a reasonable and timely basis.<sup>41</sup> Therefore, there is no reason to find that nondominant status or any other possible ill-advised steps under consideration in other proceedings are necessary to promote deployment of advanced telecommunications capability. Nonetheless, to the extent that the Commission changes its mind and concludes that broadband is not being deployed rapidly enough after all, it is clear that circumstances other than ILEC complaints about regulation fully explain the current pace of deployment of broadband.

First, there are no services for which wireline broadband services are necessary. Referred to as the lack of a “killer application,” there are simply no services not already available to consumers that would make broadband particularly desirable. Video programming is available from several sources including over-the-air broadcast, cable, satellite, videocassettes and DVDs. High speed web browsing is already available through DSL and cable modem service, although these services are not necessarily substitutes for each other. Businesses are already able to obtain the high speed services they need from ILECs. In short, the ubiquitous wireline broadband networks have not been built because there is as yet no demand for them. A government policy that effectively requires construction of these networks would at this point do no more than produce a multibillion dollar white elephant.

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<sup>41</sup> *Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996*, Third Report, CC Docket No. 98-146, FCC 02-33, released February 6, 2002, at para. 1.

Ubiquitous broadband networks have also not been built because the technical solutions that might make them affordable have not yet been invented. Recent studies show that consumers are unwilling to pay more than \$25.00/month for high speed access and that this explains why less than 5% of U.S. households subscribe to it.<sup>42</sup> The ILECs have dangled the prospect of a kind of super-broadband “passive optical network,” bringing fiber optics as close to consumers as possible.<sup>43</sup> But given that the ILECs’ own funded studies estimate that the cost of deploying such gold-plated networks nationwide would be \$270 billion to \$416 billion,<sup>44</sup> it is clear that this type of network is not currently economically feasible by any stretch of the imagination. Accordingly, even if the Commission were to comprehensively deregulate ILECs’ participation in the broadband marketplace, there is no reason to believe that this would result in widespread deployment of broadband networks, simply because the costs thereof are more than consumers are willing to pay for.

For these reasons, there is no rational basis for the Commission to conclude that nondominant treatment of ILECs’ provision of broadband services would promote broadband networks. In reality, ILEC arguments on this issue and promises to develop broadband networks are no more than self serving efforts to manipulate policy makers and should be rejected as such.

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<sup>42</sup> “Broadband Success Requires More than Regulatory Clearance, Says Research,” CLEC News, February 21, 2002, <http://www.c.ec-planet.com/news/02feb2002/18broadband.html>

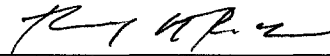
<sup>43</sup> Communications Daily, February 26, 2002, at 4-5, describing *Building a Nationwide Broadband Network: Speeding Job Growth*, Telenomic Research, February 25, 2002.

<sup>44</sup> *Id.*

### III. CONCLUSION

For these reasons, the Commission should conclude that deregulation of ILECs would not promote the goal of widespread deployment of broadband services to all Americans and should peremptorily terminate this proceeding. If the Commission determines to proceed nevertheless, it must first issue a further notice of proposed rulemaking to define the market(s) it is analyzing.

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